

Pensions Board

30 April 2019

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| Report title | LGPS Central Investment Pool Update | |
| Originating service | Pension Services | |
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Recommendation for noting:

The Pensions Board is asked to note:

1. The update on the LGPS Central investment pool product development, transition and governance arrangements.

1.0 Purpose and background

- 1.1 This report provides an update on the ongoing development of LGPS Central Ltd, a jointly owned investment management company established by West Midlands Pension Fund and seven Partner Funds to deliver investment pooling in accordance with the criteria laid down by the Secretary of State.
- 1.2 LGPS Central Ltd (“the Company”) obtained (Financial Conduct Authority (FCA) authorisation of the operator and Authorised Contractual Scheme (ACS) in January and February 2018 respectively. These represented key achievements for both the Company and Partner Funds in progressing delivery of a full operating model ahead of the April 2018 deadline and establishing a platform to assist in securing longer term investment cost savings and meet Partner Funds’ strategic investment objectives.
- 1.3 Since the Company formally launched in April 2018, investments products and services to be provided to Partner Funds have been developing, supported and overseen by the governance structures established within the Company and across the wider investment pool. The Shareholder Forum and Joint Committee (with West Midlands Pension Fund Chair of Pensions Committee nominated as Chair of Joint Committee for the first full year of operations) each met twice during 2018, with the supporting Officer group (the Practitioner Advisory Forum) meeting at least monthly. A further Shareholder meeting took place in February to approve the 2019/20 budget and business plan.

2.0 Investment Sub-Fund Development and Asset Transition

- 2.1 The first three ACS sub-funds were successfully launched on 3 April 2018 for internal passive equity sub-funds covering UK, Global ex UK and Dividend Growth, with West Midlands Pension Fund (WMPF) assets of around £5.2bn transitioned. Following the launch of the three-internal passive sub-funds, the focus for the pool has been on the product development pipeline to deliver new sub-funds to meet Partner Fund strategic investment requirements. Over the next 2-3 years, a range of internally and externally managed sub-funds are expected to be developed and launched for liquid (e.g. equities and bonds) and alternative more-illiquid asset classes (e.g. private equity, property, infrastructure).
- 2.2 The first transition which took place in April 2018 for the Fund’s internal passive equity assets, has now undergone rigorous internal audit review and has received substantial assurance on the transition of the Fund’s first £5.2bn worth of assets to LGPS Central Ltd.
- 2.3 In January, LGPS Central Ltd launched its first private equity sub-fund, 2018 vintage, following approval of a Scottish Limited Liability Partnership (SLLP). This vehicle structure is standard for private equity and other illiquid assets and has been used by other LGPS Pools. The Fund has committed to investing £200m into the 2018 vintage private equity sub-fund. The Fund has recently undertaken a consolidation exercise for some of its private equity and this commitment effectively replaces recently agreed sales.
- 2.4 The first active external equity sub-fund was launched as part of the ACS in November 2018 with total assets of £2.1 billion transitioning in February 2019 from five partner funds including around £790m from WMPF. Both a transition adviser and transition manager were appointed to assist with the transition to ensure an effective and cost-efficient transition. Full

reporting on the transition has been provided to the Fund, which provides the assurances required on the safe transfer of assets to LGPSC Ltd.

- 2.5 Other sub-funds currently in development and due for launch within the next quarter include an emerging market external active sub-fund and corporate bond sub-fund. The emerging manager sub-fund procurement process has now completed with three managers having been appointed. The managers presented during the LGPS Central Limited Annual Stakeholder Day in February 2019. The process is now underway to gain FCA approval for the addition of the sub-fund.
- 2.6 The corporate bond sub-fund procurement has also now been finalised with two external managers being appointed and due diligence of this product is ongoing. The Fund's Investment Advisory Panel, comprising external advisers, the Director of Pensions, Assistant Director and Interim Assistant Director continue to review both the emerging market and corporate bond funds before finalising decisions on transition.
- 2.7 West Midlands Pension Fund officers have been working closely with LGPS Central Ltd Investment Director, Passive Equities to consider the development of a low carbon factor-based index fund and it is anticipated that this will launch later this year. Whilst the sub-fund is still in the development phase, the design has been developed with and reviewed by the Fund's Investment Advisory Panel.
- 2.8 Pensions Committee have re-confirmed delegations in place to transition assets as appropriate to these emerging sub-funds, with final decisions and amounts transitioned to be confirmed, taking into account strategic asset allocation requirements and officers completing due diligence and gaining necessary assurance to delegate the implementation of investment management to each of these sub-funds.
- 2.9 Fund Officers continue to work closely with Partner Funds and the Company in considering the future product development pipeline for sub-fund launches, recognising changing strategic investment priorities, available resource within LGPS Central Ltd and the potential for cost savings. It is recognised that the development pipeline needs to be flexible and may well differ from the original timetable set out in the business plan.

3.0 Governance

- 3.1 As noted in previous Pension Board papers, the governance arrangements for the LGPS Central pool include a Shareholder Forum (as the group of "owner" representatives) and the Joint Committee (focused on investment matters and client-side). The Joint Committee has invited a trade union representative to join the Committee and is waiting for a nomination from the TUC. A representative from the West Midlands' Pension Committee is currently attending on an informal basis. The Practitioners Advisory Forum, PAF (officer group) support both groups and acts as a liaison with the Company.
- 3.2 The Shareholder Forum and company shareholder meeting took place on 12 February 2019 to approve the budget for the 2019/20 financial year along with the business plan. PAF worked closely with the company on the development of the budget and business plan, gaining assurance over the future financial and wider resourcing requirements of the company in advance of the shareholder meeting.

- 3.3 The next meeting of the Joint Committee is due to take place in June 2019 where the Committee will consider items which focus on the Committee's role as investors, hence will be covering items such as performance, risk management and general oversight of the operations of LGPSC Ltd.
- 3.4 The Practitioners Advisory Forum (PAF) continues to meet monthly, PAF working groups covering investment product development, responsible investment, finance, client oversight and governance are established with all groups focused on supporting the ongoing work programme of the Central pool. Work has progressed on a LGPS Pool Risk Register, which is next due to be presented to the Joint Committee in June 2019. The work of the client oversight and governance group is particularly focused on ensuring the reporting from the company meets the requirements of the Partner Funds to ensure full transparency and disclosure, part of which will be the delivery of focused and measurable service level agreements with the Partner Funds.
- 3.5 Following the recent draft guidance issued by MHCLG, whilst awaiting the final guidance, PAF is working closely to review any additional requirements arising as a result, noting in particular, the emphasis on the Pool governance structures, and expectation that Administering Authorities undertake oversight and scrutiny of the Pool operating companies.
- 3.6 The internal audit teams of Partner Funds have been working closely together to develop an audit assurance framework with the company. This will not only assist with ensuring that there is a comprehensive and robust internal audit approach across all Partner Funds, but also avoid duplication of work in particular for the company dealing with the internal audit teams of the Partner Funds. The audit group is also working to develop an audit transition framework, again to help oversee all the transitions taking place and help provide Partner Funds with the necessary assurances on transition.
- 3.7 LGPS Central Limited's own governance arrangements include an Investment Committee, Executive Committee and oversight from the Non-Executives through the company board and sub committees (Remuneration and Audit and Compliance). The Company Board continues to meet monthly. The Company also sought and obtained permission from shareholders to recruit for an additional non-executive director.
- 3.8 Following the resignation of the previous Chief Executive of LGPSC Ltd, the Board undertook an executive search to find a replacement. Mike Weston was appointed by the Board as the new CEO following ratification from shareholders at the Shareholder meeting in February. Mike has wide ranging experience in investments having most recently been at the Pension Infrastructure Platform and prior to that at the Daily Mail and General Trust. A link to the announcement and background information on Mike Weston can be found at:
<https://www.lgpscentral.co.uk/mike-weston-appointed-chief-executive-of-lgps-central-ltd/>

4.0 Financial implications

- 4.1 As previously reported, the final cost of setting up the jointly owned company (over the period July 2016 to launch in April 2018) was just over £4 million; this has been shared equally between the Partner Funds, with West Midlands' share being slightly over £500,000.

- 4.2 The Company's operating budget for 2018/19 was £9.1 million and assumed a progressive build of employees and capability over the year. Whilst awaiting the final outturn for the year as noted at previous Pension Board meetings, the Company is expected to come in under budget for the year due to some delays in recruitment, most notably of investment staff. The operating budget forecast for 2019/20 is £10.6 million, in line with projection from the prior year. The was approved by Shareholders alongside the Company's strategic business plan for the year at the Company meeting in February.
- 4.3 The ongoing cost of running the FCA-regulated Company operator LGPS Central Ltd and the recharges arising fall under 3 key categories: governance; operator; investment management charges, with governance costs shared on a 1/8th basis and operator and investment management charges shared on an assets under management basis.
- 4.4 New CIPFA guidance on the Pension Fund Annual Reports will require all Pension Funds to fully disclose progress and costs in relation to both the ongoing management of the Pool and transition, thereby providing high levels of oversight on the implementation of investment pooling and the delivery against the business case. The new reporting format is required for the 2018/19 annual report and requires Funds to report in detail on the pool set up costs; ongoing investment management costs both inside and outside the pool and the savings being delivered by pooling.

5.0 Recruitment and HR

- 5.1 In addition to the appointment of the new CEO, John Burns, the Chief Operating Officer has been appointed to the role of Deputy CEO.
- 5.2 In the investment division, recruitment to the post of Investment Director, Active Equities remains ongoing. A deputy CIO has been appointed from within the organisation, with the Investment Director, Fixed Income taking on additional responsibility in the deputy role.

6.0 Communications

- 6.1 The Company held a stakeholder day in Wolverhampton on 27th February 2019, with a number of the Fund's Pension Committee and Local Pension Board members in attendance. The Company provided an update on progress and outlook with presentations on both operational matters, plus wider economic outlook. This was followed by a product information day which saw the presentation of LGPS Central Ltd new Emerging Market Active Equity sub-fund. Further product information days are being scheduled to provide Partner Funds with detailed information as and when sub-funds are scheduled for launch.
- 6.2 The Investment Team at LGPS Central Ltd are providing Funds with quarterly strategy updates along with broader market and training information. Quarterly stewardship reports covering engagement and voting are also being provided to Partner Funds as well as being accessible on the Company website, the latest quarter can be found at:
<https://www.lgpscentral.co.uk/wp-content/uploads/2019/03/LGPS-Central-Quarterly-Stewardship-Report-Third-quarter.pdf>

6.3 Monthly and Quarterly reporting on the LGPSC Ltd sub-funds is being provided and the client oversight and governance group is working closely with the Company to further develop these reports to ensure that they will meet the reporting requirements of Partner Funds as the range of products and assets under management grows.

7.0 Legal implications

7.1 The requirement to pool fund investments is a requirement of law, failure to work collaboratively and meet the Government's criteria and timetable for delivery may result in Government intervention.

7.2 The key risks are: -

- failure to manage costs and savings in line with the agreed business case
- failure to meet the requirements of the FCA regulator
- failure to recruit appropriately skilled and experienced senior personnel to the new company

7.3 Comprehensive programme governance arrangements are in place to ensure that the statutory deadline for the implementation of pooling was achieved and that costs and savings are managed in accordance with the agreed business case. The S151 officers of each of the Partner Funds (or their nominated representative) sit on the Practitioners Advisory Forum, the Director of Pensions and Assistant Director, Investments and Finance are the WMPF/WMITA representatives on PAF. Regular meetings are held between the Chairs and/or Vice-Chairs/Nominated representative of the respective Pension Fund Committees which forms the Shareholder Forum and the Joint Committee.

7.4 MHCLG issued updated draft statutory guidance relating to investment pooling for informal consultation in January 2019. Both the Fund and LGPSC Ltd have provided responses to the consultation and are now awaiting feedback and updated guidance. Whilst the guidance was in draft format, Partner Funds are looking to ensure that they are able to respond once issued in a final format.

8.0 Equalities implications

8.1 There are no direct implications

9.0 Environmental implications

9.1 There are no direct implications

10.0 Human resources implications

10.1 Employees who were previously employed by the Partner Funds to manage their investments or perform other related activities transferred under the Transfer of Undertakings (Protection of Employment) regulations (TUPE) to the new company in April 2018. This followed detailed consideration of current and future roles, TUPE meetings with all relevant staff and formal notification of the transfers.

11.0 Corporate landlord implications

- 11.1 LGPS Central Ltd is based at 2 locations, Wolverhampton and Matlock, Derbyshire.
- 11.2 The office in Wolverhampton is based in Mander House, and the office in Matlock is based in Derbyshire County Council Offices.

12.0 Schedule of background papers

- 12.1 Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016
<http://www.legislation.gov.uk/uksi/2016/946/contents/made>
- 12.2 Public Contracts Regulations 2015
<http://www.legislation.gov.uk/uksi/2015/102/contents/made>

13.0 Schedule of Appendices

- 13.1 None